

**STATE OF WASHINGTON  
OFFICE OF THE INSURANCE  
COMMISSIONER**



**FINANCIAL EXAMINATION  
OF  
NORTH COAST LIFE INSURANCE COMPANY  
SPOKANE, WASHINGTON  
NAIC CODE 67059  
DECEMBER 31, 2004**

Participating States:  
Washington

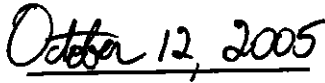
Order No. G05-76  
Exhibit A

CHIEF EXAMINER'S AFFIDAVIT

I hereby certify I have read the attached Report of the Financial Examination of the North Coast Life Insurance Company of Spokane, Washington. This report shows the financial condition and related corporate matters as of December 31, 2004.



Patrick H. McNaughton  
Chief Examiner



Date

## TABLE OF CONTENTS

<b>SCOPE OF THE EXAMINATION .....</b>	<b>1</b>
<b>INSTRUCTIONS.....</b>	<b>1</b>
<b>COMMENTS AND RECOMMENDATIONS.....</b>	<b>5</b>
<b>COMPANY PROFILE .....</b>	<b>9</b>
Company History .....	9
Capitalization.....	9
Territory and Plan of Operation.....	9
Business in Force By State .....	10
<b>AFFILIATED COMPANIES .....</b>	<b>11</b>
Intercompany Contracts .....	11
<b>MANAGEMENT AND CONTROL .....</b>	<b>12</b>
Ownership.....	12
Board of Directors .....	12
Officers .....	12
Committees .....	13
Conflict of Interest.....	13
Fidelity Bond and Other Insurance.....	13
Officers', Employees', and Agents' Welfare and Pension Plans .....	13
<b>CORPORATE RECORDS.....</b>	<b>13</b>
<b>MORTALITY AND LOSS.....</b>	<b>13</b>
<b>REINSURANCE.....</b>	<b>14</b>
<b>STATUTORY DEPOSITS .....</b>	<b>15</b>
<b>ACCOUNTING RECORDS AND PROCEDURES .....</b>	<b>15</b>
<b>SUBSEQUENT EVENTS .....</b>	<b>15</b>
<b>FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS .....</b>	<b>15</b>
<b>FINANCIAL STATEMENTS .....</b>	<b>16</b>
Assets, Liabilities, Surplus and Other Funds .....	17
Summary of Operations .....	19
Reconciliation of Surplus for the Period Since the Last Examination .....	21
Analysis of Changes in Financial Statements Resulting from the Examination.....	22
<b>NOTES TO FINANCIAL STATEMENTS .....</b>	<b>23</b>
<b>ACKNOWLEDGEMENT .....</b>	<b>24</b>
<b>AFFIDAVIT.....</b>	<b>25</b>

SALUTATION

Seattle, Washington  
October 12, 2005

The Honorable Alfred W. Gross, Commissioner  
Chair, NAIC Financial Condition (E) Committee  
State Corporation Commission  
Bureau of Insurance  
Commonwealth of Virginia  
PO Box 1157  
Richmond, VA 23218

The Honorable Linda Hall, Director  
Alaska Division of Insurance  
Secretary, Western Zone  
550 West 7<sup>th</sup> Avenue, Suite 1650  
Anchorage, AK 99501-3567

The Honorable Mike Kreidler, Commissioner  
Washington State Office of the Insurance Commissioner (OIC)  
302-14<sup>th</sup> Avenue SW  
Olympia, WA 98504

Dear Commissioners and Director:

In accordance with your instructions and in compliance with the statutory requirements of RCW 48.03.010, an Association examination was made of the corporate affairs and financial records of

NORTH COAST LIFE INSURANCE  
COMPANY  
of  
Spokane, Washington

hereinafter referred to as "NCLIC" or "the Company", at its home office located at W. 1116 Riverside, Spokane, Washington. The following report on the examination is respectfully submitted showing the condition of the Company as of December 31, 2004.

## **SCOPE OF THE EXAMINATION**

This examination covers the period January 1, 2001 through December 31, 2004 and comprises a comprehensive review of the books and records of the Company. The examination followed the statutory requirements contained in the Washington Administration Code (WAC), and Revised Code of Washington (RCW), and the guidelines recommended by the National Association of Insurance Commissioners (NAIC) Financial Condition Examiners Handbook (FCEH). The examination included identification and disposition of material transactions and events occurring subsequent to the date of examination that were noted during the examination.

Corporate records, external reference materials, and various aspects of the Company's operating procedures and financial records were reviewed and tested during the course of this examination and are commented upon in the following sections of this report. In addition, the Company's certified public accountant's (CPA's) work papers were reviewed and utilized, where possible, to facilitate efficiency in the examination.

## **INSTRUCTIONS**

The examiners reviewed the Company's filed 2004 NAIC Annual Statement as part of the statutory examination. This review was performed to determine if the Company completed the NAIC Annual Statement in accordance with the NAIC Annual Statement Instructions and to determine if the Company's accounts and records were prepared and maintained in accordance with Title 48 RCW and Title 284 WAC, and the NAIC Statements of Statutory Accounting Principles (SSAP) as contained in the Accounting Practices and Procedures Manual (AP&P).

The following summarizes the exceptions noted while performing this review.

### **1. Custodial Agreement**

In the 2004 NAIC Annual Statement Interrogatory #22.01, the Company stated that its Custodial Agreement with US Bancorp complied with the NAIC FCEH. However, the results of the examination disclosed the following:

The Agreement does not state that US Bank shall hold the certificated securities of NCLIC separate from all other securities or in fungible bulk.

- The Agreement does not state that securities held in fungible bulk by US Bank, in a clearing corporation, or in the Federal Reserve book-entry system, shall be separately identified on US Bank's official records as being owned by NCLIC.
- The Agreement does not require that securities, other than those held to meet depository requirements, shall be withdrawable upon demand by NCLIC.

- The Agreement does not state that all transfers shall be provided to NCLIC in hard copy or electronic format.
- The Agreement does not require that in the event there is a loss of securities for which US Bank is obligated to indemnify NCLIC, US Bank shall promptly replace the securities or the value of said securities and the value of any loss of rights or privileges resulting from the loss of said securities.
- In the event US Bank gains entry into a clearing corporation through an agent, the Agreement does not require US Bank to enter into a written agreement subjecting the agent to the same liability as US Bank for the loss of securities.
- The Agreement does not require that in the event the Agreement is terminated or if 100% of the account assets of any one custody account are withdrawn, US Bank will provide the OIC written notification within three (3) business days of termination or withdrawal.
- The Agreement does not require that, on reasonable notice, the OIC shall be entitled to examine, on US Bank's premises, the bank's records regarding NCLIC securities.
- The Agreement does not require US Bank and its agents, upon reasonable request, to send to NCLIC all internal control reports received from a clearing corporation or the Federal Reserve book-entry system, which the clearing corporation or the Federal Reserve permits to be redistributed, or such reports prepared by US Bank's external auditor.
- The Agreement does not require US Bank to maintain records sufficient to determine and verify the bank's financial information used by NCLIC in the preparation of its annual statements and supporting schedules.

**The Company is instructed to follow the NAIC's Annual Statement Instructions and the AP&P, as required by WAC 284-07-050(2). Adherence to the FCEH is included in these requirements, so the Company is instructed to correct all deficiencies noted above and to execute a revised or amended custodial agreement.**

## **2. Affiliated Transactions**

The Company records transactions of its affiliates, West 1116 Riverside Partnership and West 1124 Riverside Partnership, in a suspense account within its own general ledger. These items are unrelated to the operations of NCLIC and should not be so recorded. The Company did change its procedures in February 2005 to eliminate these transactions from its general ledger.

**The Company is instructed to comply with RCW 48.05.280 and to keep full and adequate accounts and records of its assets, obligations, transactions, and affairs.**

### **3. Unauthorized Reinsurance**

Effective January 1, 2004, NCLIC entered into an agreement to be the fronting company for a "Cancer Medical Reimbursement Plan" (CMRP) product. This product is 100% reinsured by International Reinsurance Company Ltd (IRC), an alien, unauthorized reinsurer. RCW 48.12.166(1) and (2) requires assuming alien reinsurers to register and to annually renew such registration with the commissioner, but IRC has not done so. In addition, RCW 48.12.160(1)(c)(i) and (ii) requires unauthorized reinsurers to deposit qualified funds or assets in a bank which is a member of the Federal Reserve System or to furnish a "...clean, irrevocable, and unconditional letter of credit...", with a term of at least one year, in a qualifying United States bank, equal to the amount of credit taken on the ceded risks. (All of these requirements are also contained in SSAP No. 61, paragraph 42 and Appendix A-785). The required deposit or letter of credit (LOC) has not been obtained, so no credit can be taken for the reserves ceded under this agreement and examination adjustment number 1 will be made to charge Surplus for the \$ 107,362 of reserves ceded under this contract.

The Company also did not request approval for the group certificates from the OIC or the California insurance regulators nor did it attempt to validate the plan's prior history or its predecessor's reason for termination. These lapses, plus the failure to confirm IRC's registration and to secure the LOC constitute a breach of the fiduciary responsibility required by RCW 48.05.370.

**The Company is instructed to comply with RCW 48.05.073 and WAC 284-07-500(2) and to file its financial statements in accordance with the RCW and AP&P by eliminating any unauthorized reserve credits which are not secured by deposits or an LOC, as required by RCW 48.12.160(1)(c)(i) or (ii).**

**NCLIC is further instructed to ensure that its officers and directors comply with RCW 48.05.370, which requires that they discharge their duties with the diligence, care and skill which ordinary, prudent men would exercise in similar situations. This includes ensuring that the Company officers and directors fully and critically evaluate proposed significant transactions and agreements before executing them. In the case of the CMRP, this evaluation is overdue and serious consideration should be given to terminating this agreement.**

#### **4. Mortgage Loans Valuation**

The Company invested in purchase money mortgages without complying with the RCW 48.12.200(1) limitations, which restrict such loans to 90% of a property's fair value at the date of the loan. Since the mortgages have subsequently been written down to less than 90%, no examination adjustment has been made.

**The Company is instructed to adhere to RCW 48.12.200(1) by limiting purchase money mortgage loans to 90% of the properties' fair value.**

#### **5. NAIC Annual Statement Preparation**

Every insurer must prepare its financial statements in accordance with the AP&P. In preparing its 2004 NAIC Annual Statement, NCLIC did not follow the NAIC Annual Statement Instructions in the following areas:

- \$14,974 of policyholder checks that are pending escheat should be recorded as aggregate write-ins for liabilities on page 3, line 25 of the 2004 NAIC Annual Statement and not shown as remittances and items not allocated on page 3, line 19.
- \$16,088 of treasury stock should be shown on the 2004 NAIC Annual Statement page 3, line 36.1 (treasury stock) and not included in remittances and items not allocated on page 3, line 19.
- According to the Notes to the Financial Statements in the 2004 NAIC Annual Statement, Note No. 13, the Company has 800,000 shares of common stock authorized. According to the amended Articles of Incorporation filed with the OIC, dated September 9, 2000, the number of authorized shares was increased to 1,500,000 shares.
- Transactions with an unauthorized reinsurer, International Reinsurance Company Ltd were reported on Schedule S, part 2 and 3 instead of Schedule S, part 4.

**The Company is instructed to comply with RCW 48.05.073 which requires the filing of its financial statements in accordance with the AP&P; and WAC 284-07-050(2) which requires adherence to the NAIC Annual Statement Instructions and the AP&P.**

#### **6. Change in Number of Board Members**

The Company reduced its number of Directors from twelve to nine, without approval of its shareholders as required by its By-Laws. Per RCW 24.06.130, a company cannot



change the number of its Directors, unless it amends its By-Laws or Articles of Incorporation.

**In accordance with RCW 24.06.130, which requires that a change in the number of Directors be made through an amendment to the By-Laws or Articles of Incorporation, the Company is instructed to amend its By-Laws to reduce the number of directors to nine or to bring the number of directors in conformity with the existing By-Laws.**

## **7. IBNR**

Based on a review by the OIC actuary, the IBNR used by the Company on its 2004 NAIC Annual Statement did not reflect the actual experience of the Company. Examination adjustment number 2 will be made, charging Surplus and increasing the IBNR by \$76,355 to reflect the actual experience.

**The Company is instructed to comply with RCW 48.12.030(2) and record the amount necessary to pay all of its losses and claims whether paid or unpaid. This would include recording the IBNR that closely approximates the actual experience of the Company.**

## **COMMENTS AND RECOMMENDATIONS**

### **1. Business Contingency Plan**

NCLIC does not have a formal, written, Business Contingency Plan that addresses the continuation of all significant business activities such as claims, policy service and payroll.

**It is recommended that NCLIC follow the NAIC Guidelines concerning disruptions of normal business activities and implement a Business Contingency Plan to ensure continuation of all significant business services, including financial functions, customer service and telecommunication systems.**

### **2. Property Insurance**

The building occupied by the Company is owned by an affiliate, West 1116 Riverside Partners, but the property insurance is in the name of NCLIC. Premiums are paid by NCLIC and allocated back to the partnership at year-end.

**To avoid problems in the event of a loss, it is recommended that the property insurance on the West 1116 Riverside building should be in the name of its owner, West 1116 Riverside Partners.**

### **3. Policy and Claim File Security**

The policy and claim files are not kept in a secure or fireproof area. Instead, they are located in the main working area and can be accessed by anyone.

**To protect all valuable and private information, it is recommended that the Company keep the policy and claim files in a secure area.**

### **4. Employee Handbook**

The Employee Handbook (EH) was written in 1991 and contains some employment policies and procedures which have changed or have not been followed. This is particularly true regarding the employee benefit plan and performance reviews. In 1991, the Company had a defined benefit plan which is described in the Employee Handbook. In 1996, the Company eliminated this plan and changed to a 401K defined contribution plan. Also, annual performance reviews are generally not performed, contrary to a recommendation in the last examination report. Erroneous descriptions of employee benefits and practices are obviously not helpful to employees and could lead to breach of contract allegations by them.

**In order to provide guidance for employees and to avoid possible litigation, it is recommended that NCLIC update its Employee Handbook to reflect current conditions.**

### **5. Private Placements and Foreign Investments**

Investment in private placements is not permitted by the Company's investment policy. However, the Company reported private placements on schedule D of its 2004 NAIC Annual Statement.

In addition, the Company did not check its foreign investments for compliance with RCW 48.13.180(2), although subsequent research did not discover any disqualification of these investments under that provision.

**A company's investment policy is an internal control feature and should be followed in order to safeguard its assets. Therefore, NCLIC should either follow or revise its policy, subject to any required approval process. Private placements have restricted liquidity and special valuation problems. If the investment policy is modified to permit private placement investments, it is recommended that the Company obtain a better understanding of private placements before investing therein and maintain ongoing contact with originators or managers. Additionally, prospective foreign**

**investments should be appropriately screened in accordance with RCW 48.13.180(2).**

#### **6. Documentation of Procedures and Reconciliations**

The Company does not have written procedures for cash receipts and disbursements, premiums and claims processing, and investment reconciliations.

**It is recommended that the Company implement written procedures documenting all important processes and reconciliations.**

#### **7. Directors and Officers' Liability Insurance**

The Company does not have directors' and officers' liability insurance. The Company states that it is not economically feasible at the current time.

**Directors' and officers' liability coverage is important to protect the Company's assets and it is recommended that the Company obtain this insurance.**

#### **8. Intercompany Agreements**

The Company has two intercompany agreements, a management contract with West 1116 Riverside Partners, 1124 Riverside Partners and RJM, and a mortgage loan servicing agreement with RJM.

Due to the cessation of work performed for the affiliates and the declining number of NCLIC's mortgages, the Company no longer has transactions under either contract and does not expect to have any in the future.

**In order to recognize the current reality concerning these intercompany agreements, it is recommended that the Company formally cancel the affiliated company service and mortgage loan contracts.**

## **9. Investment Transactions**

The Company's President makes all investment decisions, which are subsequently reviewed by the investment committee during its quarterly meetings. The committee then makes recommendations to the President for future investments.

Important investment decisions benefit from the prospective consideration of different viewpoints and it is difficult to revise a transaction retroactively. A case in point recently occurred when the Company inadvertently exceeded statutorily-imposed limitations on the holding of preferred stock during a time when the President was unavailable. Also, Best's Insurance Report stated that NCLIC has previously experienced investment valuation problems.

Control should be improved if the Company appointed an investment firm to manage the portfolio, subject to specific performance guidelines and restrictions. The President could then evaluate the firm's performance on an ongoing basis, without the obligation to make day-to-day investment decisions. In addition, the Investment Committee would have two levels of control on which to rely when continuing its current oversight role. Although such a system should pay for itself on a net basis, the gross cost of an outside manager could probably be minimized if a well-reputed regional firm could be found to provide this function for a reasonable fee.

**It is recommended that the Company utilize an investment firm to manage the investment portfolio, subject to agreed performance objectives and restrictions, leaving the President and the investment committee to review and oversee the investment decisions.**

## **COMPANY PROFILE**

### **Company History**

The Company was incorporated under the laws of the state of Washington on February 5, 1965, as a stock life insurance company and commenced business on May 3, 1965. Since incorporation, the Company has acquired or merged business from a number of insurance companies.

### **Capitalization**

At the end of 2004, there were 182 common shareholders owning 611,983 shares with a par value of \$3.50 each, giving a total par value of \$2,141,941. There were 204 preferred shareholders owning 362,690 outstanding shares with a par value of \$1 each and a total outstanding par value of \$362,690. There were also \$400,000 of surplus notes and paid-in surplus of \$5,140,431. Unassigned surplus was a deficit of \$1,873,613, resulting in a total capitalization of \$6,171,449.

### **Territory and Plan of Operation**

The Company markets interest-sensitive whole life, term, and flexible premium deferred annuity contracts in 12 states, Guam and the Commonwealth of the Northern Marianas. The majority of the Company's business is generated in California, Washington, and Arizona.

NCLIC is represented by a field force of approximately 200 independent agents and 42 brokers all of whom hold non-exclusive contracts.

## Growth of Company

The Company's growth, as reported in its filed NAIC Annual Statements, is illustrated below.

	<u>Assets</u>	<u>Liabilities</u>	<u>Capital and Surplus</u>
2001	\$87,031,247	\$81,345,674	\$5,685,573
2002	92,985,573	87,728,994	5,256,579
2003	97,668,927	91,941,153	5,727,774
2004	119,774,058	113,602,609	6,171,449

	<u>Premiums</u>	<u>Net Investment Income</u>	<u>Annuity Benefits</u>
2001	\$5,482,650	\$6,158,852	\$2,314,666
2002	6,071,636	6,404,738	1,686,705
2003	6,880,186	6,264,631	1,680,740
2004	22,797,036	6,893,770	2,671,514

## Business in Force by State

Alabama	\$67,063	New Hampshire	\$104,115
Alaska	3,058,400	New Jersey	154,555
Arizona	53,577,740	New Mexico	14,353,276
Arkansas	173,192	New York	247,476
California	213,342,390	North Carolina	77,368
Colorado	1,950,427	N. Mariana Islands	8,647,189
Connecticut	51,467	Ohio	310,324
Federated States Of Micronesia	1,493,518	Oklahoma	110,748
Florida	1,100,639	Oregon	42,522,754
Georgia	597,635	Pennsylvania	159,583
Hawaii	31,656,371	Palau Islands	279,581
Idaho	28,973,362	Rhode Island	59,364
Illinois	219,240	South Carolina	357,649
Indiana	399,000	South Dakota	466,650
Iowa	153,974	Tennessee	143,187
Kansas	141,015	Texas	1,958,776
Kentucky	26,459	Utah	27,858,685
Louisiana	249,994	Vermont	302,000
Maine	10,060	Virginia	543,601
Marshall Islands	993,780	Washington	43,128,020
Maryland	560,662	West Virginia	98,717

Massachusetts	52,837	Wisconsin	225,443
Michigan	380,415	Wyoming	2,744,217
Minnesota	125,357	Guam	11,839,672
Mississippi	89,191	Canada	8,337
Missouri	706,503	Military Post Office	100,000
Montana	2,193,925	Unknown	<u>752,761</u>
Nebraska	164,607		
Nevada	7,064,907		
Total Business In Force			<u>\$507,598,291</u>

## **AFFILIATED COMPANIES**

### **R. J. Martin Mortgage Company**

R. J. Martin Mortgage Company (RJM) is closely-held mortgage finance and servicing company. RJM owns approximately 51% of NCLIC and is controlled by C. Robert Ogden, President of NCLIC.

### **West 1116 Riverside Avenue Partners**

The West 1116 Riverside Avenue partnership was originally formed in 1989 by NCLIC, RJM, and C. Robert and Margaret M. Ogden, to purchase the Company's home office.

### **West 1124 Riverside Avenue Partners**

West 1124 Riverside Avenue Partnership, a real estate management partnership, was formed in 1992 to purchase the commercial office building adjacent to NCLIC's home office building. C. Robert Ogden is the managing partner of West 1124 Riverside Avenue Partners. As of December 31, 2004, the ownership percentages of West 1124 Riverside Partners was as follows: NCLIC 77.4%; RJM, 10.8%; C. Robert and Margaret Ogden, 5.7%; and Heylman Properties 6.1%.

### **Intercompany Contracts**

- Intercompany agreement with West 1116 Riverside Partners, 1124 Riverside Partners and RJM
- Mortgage loan servicing agreement with RJM

Due to the lack of work performed for the affiliates, and the reduced number of mortgages NCLIC owns, neither contract is operative.

## **MANAGEMENT AND CONTROL**

### **Ownership**

The Company's President, C. Robert Ogden, is its ultimate controlling person. Mr. Ogden and his immediate family control approximately 79% of the outstanding common stock of NCLIC.

Significant shareholders of the common stock include the following:

R. J. Martin Mortgage Company	306,042 shares
C. Robert Ogden and Members of his family	116,258 shares
W. 1116 Riverside Partners	59,891 shares

### **Board of Directors**

As of December 31, 2004, the Company had a nine-member Board of Directors (BOD) consisting of the following:

<b>Name</b>	<b>Principal Business Affiliation</b>
C. Robert Ogden	President of NCLIC
Ronald Drake Andrews	Owner and operator of Andrews Orchards
Gavin John Cooley	CFO, City of Spokane
William Carlin Fix	President, William C. Fix Investments
Nicholas Ross Knapton	Certified Public Accountant, McDirmid, Mikkelsen & Secrest
David Martin Ogden	Owner, Clear Creek Recording Studios
Douglas Hunter Ogden	Attorney, VP & General Counsel, Alternative Energy Institute
Robert James Ogden	Vice President of NCLIC
Ronald Robert Snyder	President, Selkirk Investments, Inc.

The by-Laws vest the management and control of the affairs of the Company in a BOD consisting of twelve members, a majority of whom must be Washington residents. In 2004, the Company reduced the BOD to nine members without the shareholder approval which is required by its by-laws.

**Officers:** The officers as of December 31, 2004 were:

<b><u>Name</u></b>	<b><u>Title</u></b>
C. Robert Ogden	President
Clifford Dale Kutsch	Secretary
Robin Lee Johnston	Treasurer



## **Committees**

The Company has an executive committee, an investment committee, an audit committee and a management committee.

## **Conflict of Interest**

NCLIC has a policy statement and questionnaire to disclose conflicts of interest which all directors, officers and key employees are required to sign. These are reviewed by the President for any irregularities.

## **Fidelity Bond and Other Insurance**

The Company uses a broker to monitor its insurance needs and to obtain the necessary coverage. Except for a lack of Directors and Officers liability insurance, the Company has no obvious gaps in its coverage. (See Comment and Recommendation #6)

## **Officers', Employees', and Agents' Welfare and Pension Plans**

The Company has no Defined Benefit Plan.

The Company maintains an I.R.C. Section 401k Retirement Plan. Under the plan, the Company annually matches employee contributions. The Company matches the first \$600 employee contribution at 100% and the next \$600 employee contribution at 50%, for a maximum annual contribution of \$900.

## **CORPORATE RECORDS**

The corporate records were reviewed for the period under examination. All board meetings were conducted with a quorum present. There have been no changes to the Articles of Incorporation or By-Laws since the last examination.

## **MORTALITY AND LOSS**

NCLIC provided copies of its actuarial workpapers and reserve reports as of December 31, 2004. Tests were performed on the underlying data, methods, and calculations as deemed necessary. Valuation reports and procedures were tested to establish that accurate and complete in-force information as of December 31, 2004 was represented in the valuation reports and workpapers. A sampling of contracts and payments was taken from active life and disabled life reserve reports, premium collection records and paid claims reports. The samples were tested for completeness and accuracy and it was

determined that the Company's calculations were based on accurate and complete demographic data.

During the course of the examination, the OIC actuary performed such testing of the Company's reserving methodologies and philosophies as was deemed necessary to form an opinion with respect to the items reported. The actuary relied upon the Company's listings and summaries of in-force policies and contracts.

The general examination emphasis was to review the methods, assumptions or other bases used to determine the reported NAIC Annual Statement items, and to determine whether the reported amounts are sufficient and in compliance with Washington law.

In the OIC actuary's opinion, the methods, assumptions and methodologies used by the Company are generally appropriate except for the calculation of the IBNR reserves, which was not appropriate based on the Company's actual experience. An adjustment for \$76,355 is proposed. The Company also did not have reserves set up on its Cancer Care business with an unauthorized reinsurer (see Instruction No. 3). A reserve of \$107,362 has been proposed. Besides the previous two items, all material relevant assets and liabilities on the NAIC Annual Statement were reported in accordance with accepted methods and principles.

### **REINSURANCE**

The Company assumes no reinsurance. It has a number of ceded contracts with authorized reinsurers, covering various product segments. Depending on the contract, cessions are made on a renewable term, coinsurance or modified coinsurance basis. There is also a 100% quota share financial reinsurance agreement covering certain ordinary life policy groups, which will conclude at the end of 2005.

In addition, effective January 1, 2004, NCLIC entered a 100% quota share (fronting) agreement for a Cancer Medical Reimbursement Plan (CMRP). Under the agreement, the Company receives 10% of gross premiums to cover up to \$1,000,000 per person of unreimbursed medical expenses for cancer and up to \$25,000 of expenses for some other "dread diseases" (DD). The insured persons are obliged to carry primary medical expense insurance covering 70% of their eligible medical benefits.

NCLIC's explicit minimum obligation under the CMRP plan would be for up to \$500 of the primary plan's deductible for cancer and DD-related expenses, plus any coinsurance payments required by the policyholder's primary plan. Since the CMRP policy promises "100% reimbursement for covered medical expenses", NCLIC also has an obligation for the remaining 30% of covered medical expenses not reimbursed by the primary plan. All of the Company's obligations are reinsured by International Reinsurance Company Ltd (IRC), up to \$1,000,000 per person. IRC is an unauthorized reinsurer located in the Cayman Islands and is wholly-owned by the plan's administrator, who is contractually

responsible for all aspects of the plan's operations, including sales, collections, claim settlements, administrative and tax expenses.

All the contracts contain the insolvency clause required by RCW 48.12.162(1)(b).

### **STATUTORY DEPOSITS**

The Company has the following statutory deposits:

<b><u>State</u></b>	<b><u>Par Value</u></b>	<b><u>Market Value</u></b>	<b><u>Statement Value</u></b>
Washington	\$2,500,000	\$2,769,210	\$2,423,525
New Mexico	115,000	120,642	116,932

### **ACCOUNTING RECORDS AND INFORMATIONS SYSTEMS**

The Company maintains its accounting records on a Statutory Accounting Principles (SAP) basis for NAIC Annual Statement reporting. NCLIC is audited annually by a local certified public accounting firm and received an unqualified opinion for all years under review. The Company's accounting procedures, internal controls, and transaction cycles were reviewed during the planning and testing phase of the examination and no exceptions were noted.

The management of NCLIC is sufficiently knowledgeable of the information systems (IS) process. Systems development, acquisition, and maintenance controls were evaluated to gain assurance that appropriate controls are in place. Operations and application controls were reviewed to determine the type of hardware installed; operating systems and proprietary software in use; back up and recovery facilities employed; and the controls exercised to maintain data security. Sufficient internal controls are in place and monitored by the Company. NCLIC's IS Department has the ability to recover from an incident or disaster and has documented these procedures in a detailed, written disaster recovery plan.

### **SUBSEQUENT EVENTS**

The Company has elected to terminate its fronting arrangement with International Reinsurance Company and has scheduled termination for the summer of 2005.

### **FOLLOW UP ON PREVIOUS EXAMINATION FINDINGS**

All previous report instructions and comments were corrected.

## **FINANCIAL STATEMENTS**

Assets, Liabilities, Surplus and Other Funds

Summary of Operations

Reconciliation of Surplus for the Period since the Last Examination

Analysis of Changes in the Financial Statements as a Result of the  
Examination

**NORTH COAST LIFE INSURANCE COMPANY**  
**LIFE INSURANCE COMPANY**  
**ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS**  
**DECEMBER 31, 2004**

	BALANCE PER COMPANY	REF	EXAM ADJ	BALANCE PER EXAM
<u>Assets</u>				
Bonds	\$87,693,286			\$87,693,286
Preferred Stocks	9,683,809			9,683,809
Mortgage Loans - First Liens	557,893			557,893
Cash and short term investments	1,303,481			1,303,481
Real Estate	43,765			43,765
Contract loans	14,605,882			14,605,882
Other invested assets	1,910,390			1,910,390
Subtotals, cash and invested assets	115,798,506		0	115,798,506
Investment income due and accrued	1,572,903			1,572,903
Federal and foreign tax recoverable	68,321			68,321
Premiums and considerations:				
Uncollected premiums and agents' balance				83,855
In course of collection	83,855			
Deferred premiums, agents' balances and				2,057,930
installments booked but deferred and not yet due	2,057,930			
Funds held by or deposited with reinsured companies	1,335			1,335
Net deferred tax asset	162,536			162,536
Guaranty funds receivable or on deposit	14,549			14,549
EDP equipment	13,420			13,420
Aggregate write-ins	703			703
Total Assets	<u>\$119,774,058</u>		<u>\$0</u>	<u>\$119,774,058</u>
<u>Liabilities</u>				
Aggregate reserve for life contracts	\$105,071,478	2	\$76,355	\$105,147,835
Aggregate reserve for health contracts	25,093	1	107,362	132,456
Liability for deposit-type contracts	4,826,300			4,826,300
Contract claims - life	148,870			148,870
Dividends apportioned for payment	5,000			5,000
Premiums and annuity considerations received in	58,369			58,369
Interest Maintenance Reserve	1,731,421			1,731,421
General expenses due or accrued	81,272			81,272
Taxes, licenses and fees due or accrued	190,733			190,733
Current federal and foreign income taxes	55,389			55,389
Unearned investment income	339,030			339,030
Amounts withheld or retained by company as agent	4,389			4,389
Amounts held for agents account	44,748			44,748
Remittances and items not allocated	142,548			142,548
Asset valuation reserve	656,517			656,517
Payable to parent, subsidiary and affiliates	221,452			221,452
Total Liabilities	<u>\$113,602,609</u>		<u>\$183,717</u>	<u>113,786,326</u>

**NORTH COAST LIFE INSURANCE COMPANY  
LIFE INSURANCE COMPANY  
ASSETS, LIABILITIES, SURPLUS AND OTHER FUNDS (Continued)  
DECEMBER 31, 2004**

	<u>BALANCE PER COMPANY</u>	<u>REF</u>	<u>EXAM ADJ</u>	<u>BALANCE PER EXAMINATION</u>
<b><u>SURPLUS AND OTHER FUNDS</u></b>				
Common capital stock	\$2,141,941			\$2,141,941
Preferred Stock	362,690			362,690
Surplus Note	400,000			400,000
Gross Paid in and contributed	5,140,431	1&2	(183,717)	4,956,714
Unassigned funds (surplus)	<u>(1,873,613)</u>			<u>(1,873,613)</u>
Capital and surplus	<u>6,171,449</u>	1&2	<u>(183,717)</u>	<u>5,987,732</u>
Total Liabilities, Surplus and Other Funds	<u>\$119,774,058</u>		<u>\$0</u>	<u>\$119,774,058</u>

**NORTH COAST LIFE INSURANCE COMPANY**  
**SUMMARY OF OPERATIONS**  
**YEAR ENDED**  
**DECEMBER 31, 2004**

	<u>BALANCE</u> <u>PER COMPANY</u>	<u>REF</u>	<u>EXAM</u> <u>ADJ</u>	<u>BALANCE PER</u> <u>EXAMINATION</u>
<b><u>INCOME</u></b>				
Premiums and annuity considerations	\$22,797,036			\$22,797,036
Consideration for supplementary contracts	\$65,000			\$65,000
Net investment income	6,893,770			\$6,893,770
Commission and Expense Allowance	475,727			\$475,727
Reserve adjustment on reinsurance ceded	774,499			\$774,499
Aggregate write-ins for miscellaneous income	(107,187)			(\$107,187)
Amortization of Interest Maintenance Reserve	143,207			\$143,207
TOTAL INCOME	<u>\$31,042,052</u>		<u>\$0</u>	<u>\$31,042,052</u>
<b><u>BENEFITS</u></b>				
Death Benefits	\$869,437			\$869,437
Matured endowments	16,605			16,605
Annuity benefits	2,671,514			2,671,514
Disability benefits	6,025			6,025
Coupons, guaranteed and annual pure endowments	110			110
Surrender Benefits	1,488,941			1,488,941
Interest and adjustments on contracts	161,308			161,308
Payments on supplementary contracts	100,973			100,973
Increase in aggregate reserves for life and health				0
policies and contracts	<u>18,400,792</u>	1&2	<u>183,717</u>	<u>18,584,509</u>
TOTAL BENEFITS	<u>\$23,715,705</u>		<u>\$183,717</u>	<u>\$23,899,422</u>
<b><u>EXPENSES</u></b>				
Commissions on premiums and annuity considerations	1,267,311			1,267,311
General insurance expenses	2,431,803			2,431,803
Insurance taxes, licenses and fees, excl. federal income tax	295,762			295,762
Increase in loading	37,580			37,580
Aggregate write-ins for expenses	<u>2,346,946</u>			<u>2,346,946</u>
TOTAL EXPENSES AND BENEFITS	<u>\$30,095,107</u>		<u>\$0</u>	<u>\$30,278,824</u>
Net gain from operations before dividends to policyholders				
and income taxes	946,945			763,228
Dividends	(5,326)			(5,326)
Less Federal income taxes incurred (excl. tax on capital gain:	(59,230)			(59,230)
Net gain from operations after dividends to policyholders				
and income taxes but before realized capital gains (losses)	882,389			698,672
Net realized capital gains or (losses) less capital gains tax	<u>(516,592)</u>			<u>(516,592)</u>
NET INCOME	<u>\$365,797</u>		<u>\$0</u>	<u>\$182,080</u>

**NORTH COAST LIFE INSURANCE COMPANY  
SUMMARY OF OPERATIONS (CONTINUED)  
YEAR ENDED DECEMBER 31, 2004**

	BALANCE PER COMPANY	REF	EXAM ADJ	BALANCE PER EXAMINATION
<b>Capital and Surplus Account</b>				
Capital and Surplus, December 31, Previous Year	\$5,727,774			\$5,727,774
Net income	365,797	1&2	(183,717)	182,080
Change in net unrealized capital gains	783,998			783,998
Change in net deferred income tax	110,399			110,399
Change in non-admitted assets and related items	49,711			49,711
Change in asset valuation reserve	(507,754)			(507,754)
Aggregate write-ins	(358,476)			(358,476)
Net change in capital and surplus for the year	443,675		(183,717)	259,958
Capital and Surplus, December 31, 2002	\$6,171,449		(\$183,717)	\$5,987,732



**NORTH COAST LIFE INSURANCE COMPANY  
LIFE INSURANCE COMPANY  
RECONCILIATION OF SURPLUS  
FOR THE PERIOD SINCE THE LAST EXAMINATION**

	<u>2004</u>	<u>2003</u>	<u>2002</u>	<u>2001</u>
Capital and Surplus, December 31, Previous Year	\$5,727,774	\$5,256,579	\$5,685,573	\$5,998,498
Net income	365,797	455,280	(557,721)	833,518
Change in net unrealized capital gains (losses)	783,998	(588,186)	162,112	113,312
Change in net deferred income tax	110,399	64,123	420,307	
Change in non-admitted assets and related item	49,711	6,368	(442,126)	7,748
Change in asset valuation reserve	(507,754)	450,162	612,211	(310,293)
Cumulative effect of changes in accounting principles				(252,722)
Change in surplus notes		400,000		
Other		33,987		5,126
Change in surplus as a result of reinsurance	(358,476)		(351,766)	(346,922)
Dividends to Stockholders	0	(350,539)	(272,011)	(362,692)
Net change in capital and surplus for the year	<u>443,675</u>	<u>471,195</u>	<u>(428,994)</u>	<u>(312,925)</u>
Capital and surplus on December 31, 2002	<u>\$6,171,449</u>	<u>\$5,727,774</u>	<u>\$5,256,579</u>	<u>\$5,685,573</u>

**NORTH COAST LIFE INSURANCE COMPANY**  
**Analysis of Changes in Financial Statements Resulting from the Examination**  
**As of December 31, 2004**

	<u>BALANCE PER COMPANY</u>	<u>BALANCE PER EXAMINATION</u>	<u>EXAMINATION ADJUSTMENT REFERENCE</u>	<u>INCREASE (DECREASE) IN SURPLUS</u>	<u>TOTALS</u>
Capital and Surplus, December 31, 2004 - Per Annual Statement					\$6,171,449
<b><u>ASSETS</u></b>					
<b><u>LIABILITIES</u></b>					
Aggregate Reserve for Life	\$105,071,478	\$105,147,833	2	(\$76,355)	
Aggregate Reserve for A & H	25,093	132,455	1	(107,362)	
Change in Surplus					<u>(183,717)</u>
Capital and Surplus, December 31, 2004 - Per Examination					<u><u>\$5,987,732</u></u>

## **NOTES TO THE FINANCIAL STATEMENTS**


1. Reversal of reserve for unauthorized reinsurance.
2. Increase in IBNR .
3. The Company has no permitted practices or orders from the state of Washington.
4. The Company and the OIC entered into an agreement July 31, 2001 which stipulated the conditions that must be met before preferred dividends can be paid per RCW 48.08.030. In accordance with this statute and the agreement, the Company will not pay dividends without applying to, and receiving approval from, the OIC. On December 23, 2003, Company management indefinitely suspended the quarterly dividend on its preferred stock. An erosion of the credit quality in certain Company investments prompted this suspension.

### ACKNOWLEDGEMENT

The cooperation and assistance of the officers and employees of the Company during the examination are hereby acknowledged.

In addition to the undersigned, Susan Campbell, CPA, FLMI; Kathy Hicks, CPA; Friday Enoye; Alexis S. Santos, FSA, MAAA; Michael V. Jordan, CPA, CFE, MHP, and John Jacobson, AFE, CISA, all from the Washington State Office of the Insurance Commissioner participated in the examination and the preparation of this report.


Respectfully submitted,

  
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John Gaynard, CFE, CPA, FLMI  
Examiner in Charge  
Washington State Office of the Insurance Commissioner

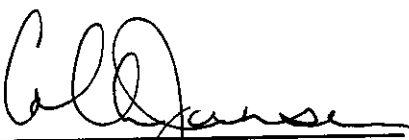
**AFFIDAVIT**

State of Washington           )  
  ) ss  
County of King                )

John Gaynard, being duly sworn, deposes and says that the foregoing report subscribed by him is true to the best of his knowledge and belief.

  
\_\_\_\_\_  
John Gaynard, CPA, CFE, RLMI  
Examiner in Charge  
State of Washington

Subscribed and sworn to before me on this 12<sup>th</sup> day of October, 2005.

  
\_\_\_\_\_  
Notary Public in and for the  
State of Washington

